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STATE FOR EAP/EP, EB/IFD, E
STATE ALSO PASS FED RESERVE SAN FRANCISCO - CURRAN
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TREASURY FOR OASIA

E.O. 12958: N/A

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SUBJECT: Prospering from the Remittance Gusher

REF: 04 Manila 5555

SUMMARY

1. Overseas Filipino Worker (OFW) remittances grew by 22% for the first seven months of 2005, and should approach \$10 billion for the year, equal to 10% of GDP. Two-thirds of remitters from the U.S. use the banking system while others go through informal channels. Surveys show recipients apply most funds to food, housing, and education though consumption of domestic goods can have a beneficial multiplier effect. Remittances are a major source of foreign exchange for the country, supporting the balance of payments and international currency reserves. The exodus of OFWs, particularly in white-collar jobs, is creating labor shortages in key sectors, such as health care and engineering. End Summary.

Dear OFW: Please Send Money

2. The Philippines is the third largest recipient of remitted funds in the world, behind only India and Mexico, in part because it has the highest rate of out-migration relative to population of any country in East or South Asia. About 9% of the population, one-quarter of the labor force, live and work overseas. The number of OFWs is growing by 2500 each day, or 800,000 annually. OFW remittance flows through banks continue to climb. According to the Bangko Sentral ng Pilipinas (BSP - the Central Bank), remittances grew by 10% to \$7.58 billion in 2003, and by almost 13% to \$8.55 billion in 2004, equivalent to 10% of GDP. For January through July 2005, the Philippines received \$5.8 billion, 22% more than during the first seven months of 2004, and could receive \$10 billion by year-end.

3. The high number of Filipino seamen account for almost 20% of remittances coursed through banks. On a regional basis, the Americas accounts for almost 60% of remittance flows, while Europe and the Middle East each accounted for about 15%, and Asia 11%. According to the World Bank, 53% of Philippine remittances were sourced from the U.S. in 2003. The data are skewed, however, because banks record the final transmission source, not where funds originated, and many funds are routed through correspondent banks in the U.S. In addition, the Asian Development Bank calculates that 24% of OFWs remit funds outside the banking system, so total remittances may actually exceed \$12-\$13 billion for 2005.

How Well Are the Funds Used?

4. In a September 14 presentation, University of the Philippines Professor Cid Terosa said that in a survey of 41,000 households receiving money from overseas, 67% of OFWs remit funds through banks, 28% use informal channels or bring the money home themselves, and 5% use agencies or friends. Seventy-five percent of the beneficiaries of OFW bank remittances withdraw 60-100% of these funds and 42% withdraw all 100%. A large proportion of the official remittances are channeled through Western Union, which uses Philippine banks, institutions, and even pawnshops throughout the country as conduits for funds. Terosa said households receiving OFW remittances obtain 33% of all their income from these remittances. The households spend the remittances in the following proportions:

Daily or regular expenses - 50%
Education - 21%
Savings and investment - 16%
Durable assets, housing - 10%
Pension, insurance - 3%

15. Terosa concluded that Philippine households have an 84% propensity to consume, leaving only 16% for savings and investment. If accurate, this rate is below the overall Philippine savings rate of 21%, which is far below the savings rate of other Asian countries (ranging from 28% for Vietnam to 48% for Singapore). A similar household survey conducted by the ADB found that food, education, and rent receive the highest use of funds. One banker who attended the seminar disputed this finding, however, noting that families spend a far greater percentage of their household income on land and house purchases, which could be considered investments. An Amcham member pointed out that education is itself an investment. One attendee noted that consumption expenditures are worthwhile if they are for basic necessities and not imported luxury goods. Categories missing from the breakdown include transportation and utility payments, which likely consume portions of the remitted funds.

16. The economic impact of remittances is likely to depend on whether households consume or invest. Although investing in productive activity is the best use of funds, even consumption generates positive multiplier effects, especially in the rural areas where remittances buy mainly domestic goods. A report on remittances financed by the Asian Development Bank concluded that investment decisions by recipients are often faulty, leading them to place money in small-scale enterprises that eventually fail or have little impact on productivity. Even those who save the money in big urban banks are not helping finance development in their home districts. In response, Local Government Units (LGU) are starting to apply resources to both attracting OFW remittances and helping recipients apply those funds productively. In Bohol, for example, the provincial government organized an investment seminar for 300 OFWs and then facilitated a match-making service to link the OFWs up to a particular project.

Benefits to Nation and Individual

17. Remittances are a major source of foreign exchange, in recent years exceeding foreign direct investment inflows by 30-50 times. As such, remittances provide crucial support to the Philippines' balance of payments (BOP) and a significant contributor to its foreign currency reserves. From 2000-2004, for example, while remittances grew from \$6 billion to over \$8 billion, the country's BOP level fluctuated between a deficit of \$500 million and a surplus of \$660 million and reserves averaged \$16 billion.

18. Given the important role remittances play in supporting the Philippine economy, there is frequent speculation whether an economic crisis or political trouble would reduce the inflow of funds. An IMF study concluded that remittances play a stabilizing role and reduce the chance of a financial contraction during political strife or economic downturns. Remittances supported household expenditures and offset the sharp falloff in capital inflows during the Asian crisis, for example. Remittances may actually increase during times of economic hardship as OFWs try to help their families meet emergency needs and remitters take advantage of a depreciated peso. A crisis outside the Philippines that reduces the employment level of OFWs, however, would be painful on recipient families and hurt the country's balance of payment.

Remittance Downsides

19. Twenty years ago, OFWs comprised mainly workers in the construction and manufacturing sectors. Today, there are fewer jobs in these sectors and more opportunities for domestic employees and seafarers. According to several surveys, a greater number of white-collar workers are choosing jobs overseas. Skilled professionals now account for over one-third of all OFWs, creating a brain drain and labor shortages in key sectors, including health care, education, engineering, and even specialized professions such as air traffic control (ref b-c). The higher pay levels are one important reason remittance flows have increased substantially in recent years. In addition, IMF studies have shown no evidence that remittances lead to lower growth because of exported labor or by discouraging work among recipients. Overlooked in the good news about OFW remittance flows, however, is that many OFWs are deciding not to return, abandoning plans to retire in the Philippines. Many are reportedly disenchanted with the bureaucracy and unstable

political situation. It is not encouraging that in a survey conducted by the University of the Philippines, 93% of young adults would choose to live overseas if given the chance.

Compounding the Benefits

10. To capture the full range of benefits from OFW financial flows, the GRP and development partners are looking at ways to reduce the cost of transferring money overseas and increase the flow of remittances through the formal banking system. As one measure, the GRP passed legislation in 2003 allowing dual citizenship and granting voting rights to OFWs. Immigration officials even channel OFWs into a special lane at the international airport to expedite their re-entry. Government oversight committees have held several hearings in recent months to examine ways of reducing the cost of transmitting funds to the Philippines. New services that allow money transfers through cellular phone networks are further cutting down on the time and expense involved in sending money and making payments. These technologies also allow greater integration of the rural banking system in the remittance business.

Johnson